STANDARDS FOR OPERATING PUBLIC HOUSING

A second major issue is the standards for services provided through public housing projects. These include the housing units themselves, the surrounding common areas and grounds, and the network of supportive services for tenants. Although under current practices PHAs determine the level and mix of services, the federal government affects these decisions through the degree of control it exercises over PHAs' management decisions, the mechanisms used to allocate funding, and the level of funding provided.

One specific question is the extent to which the federal government should set standards for public housing, and the extent to which PHAs should have flexibility to set their own standards. Currently, PHAs are responsible for deciding the level of supportive services to provide and the types of ongoing maintenance to fund--which, in turn, affects the physical quality of the units. On the other hand, the federal government sets the funding levels for public housing, which limits the feasible choices. Further, the federal government allocates modernization funds, determining which PHAs receive funds and what activities are undertaken. If it chose, the Congress could require that certain types of standards and services be provided to all public housing tenants--such as a basic health and safety standard, or access to job placement information, or babysitting services for working mothers. But it would have to ensure that these could be supported with the funding available to PHAs, or else permit the PHAs to reduce the number of units they maintained. Or, it could increase PHAs' flexibility, for example by providing formula-based funding for improvements, though it might want to establish guidelines for the use of funds to ensure that they were used to improve the quality of public housing.

A second, related question is the extent to which standards could or should be similar from program to program. While all federal housing assistance programs intend that assisted households should occupy decent housing and pay rents based on standard shares of their income, the varying approaches of particular programs will always mean that services will not be comparable across some dimensions. For example, recipients of Section 8 existing-housing aid may select units from a range of opportunities in the private market, while public housing recipients generally have little choice in unit selection. Also, public housing tenants live in projects composed solely of assisted households, while such segregation is not a necessary part of other federal assistance programs. On the other hand, tenants in the public housing program may receive a range of supportive social services not offered by private rental managers.

Just as it is difficult to compare the housing services provided from program to program, it is also difficult to compare costs to determine whether similar households receive similar treatment under different programs. For example, some households, such as large, female-headed ones, are more expensive to aid than others, such as elderly-headed ones. Thus, programs that aid relatively high proportions of large families will have relatively high average costs. Housing costs also vary across the country, so if programs differ in the geographic distribution of aid, costs will also vary. Finally, program costs vary over the short and long term, making it important to consider both in any effort to standardize costs.

Thus, in considering standards for services provided in the public housing program, the Congress will need to weigh the extent to which they should be federally required, as well as the extent to which similar households should receive treatment that is as similar as possible under all federal programs. As with other public housing issues, the outcomes will both affect and be affected by the type and level of subsidies provided.

DEGREE OF FEDERAL CONTROL OVER THE MANAGEMENT OF PUBLIC HOUSING

A third issue is the degree to which the federal government should constrain the management of public housing. Since the federal government extensively subsidizes public housing and contributes a large and growing share of PHA budgets--now nearly half--it is appropriate to ensure that federal funds be used to support federal policy goals. On the other hand, it is also important to ensure that federal constraints do not hinder the achievement of these goals.

The federal government affects the management of public housing directly through regulations and management oversight, and indirectly through the incentives contained in funding mechanisms. Current federal regulations apply to numerous aspects of PHA operations, including rent levels, admissions and evictions policy, wages of employees, and contracting and purchasing procedures. While the regulations are intended to ensure that federally subsidized activities meet federal standards and that assistance is efficiently provided, they may also add to PHA costs by increasing the time spent in documenting compliance and by limiting flexibility in decisionmaking.

HUD also oversees PHA management. Its field offices review PHA activities on an ongoing basis through reports that PHAs must supply and through scheduled on-site reviews. 2/ While this oversight enables HUD to ensure that federal policies are being implemented and to assist PHAs experiencing management difficulties, it also imposes costs on the PHAs. Further, because HUD must review all PHAs, it has only limited time to devote to those that are experiencing significant management difficulties.

Finally, the current system for subsidizing public housing includes incentives that shape PHA behavior. These incentives, described in more detail in the following chapter, affect such aspects of public housing management as: the amount of energy used by PHAs, the manner in which tenant incomes are certified and rents collected, the treatment of vacant units, and the amount of funds held in reserve. Most incentives are designed to increase the efficiency of PHA operations, although--as in the case of vacancy policies discussed earlier--not all do.

In considering the amount of federal control that should be exercised over the management of public housing, the Congress may wish to add to PHAs' incentives or flexibility in order to increase their management efficiency. Such possible efficiency gains should be weighed, however, against the value of requirements to ensure that public housing activities meet federal standards.

BROADER IMPLICATIONS OF FUNDING MECHANISMS

The current system of funding determines operating subsidies by a formula based on past costs, and sets modernization subsidies on a separate and discretionary basis. While these approaches were developed in response to problems with earlier methods, they have been criticized as inefficient and inequitable. The proposals before the Congress would modify the amount of subsidies for public housing and the way they would be allocated. As this discussion has indicated, however, changes in current subsidy mechanisms have wider implications.

Changes in the amount of subsidies would affect the standards for public housing projects and the numbers of units that could meet them. The costs of improving public housing to different levels of quality vary considerably, and at any given standard some units may cost as much as 30 times more than others to repair. Thus, at any given funding level, tradeoffs will exist between the number of units to be operated and the

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2. HUD field offices make annual on-site visits; biennial occupancy audits and engineering surveys; and quadrennial management and utility reviews.

standards that such units will meet. Further, the level of near-term funding will affect the long-term costs of public housing. An increase in current funding could lower future costs if it was used for preventive maintenance or for activities that lowered operating costs. Conversely, reduced funding now might lead to higher costs or decreased quality, if needed maintenance had to be postponed.

Changes in the manner in which subsidies are allocated would also affect the quality of public housing. The Congress could choose, for example, to eliminate the current practice of earmarking subsidies for operations or for modernization and to allow managers more flexibility in setting standards and allocating funds. This approach could lower the costs or raise the quality of public housing if PHAs were able to increase their efficiency, though it could have the opposite effect if PHAs found it difficult to develop long-range strategies for operating and maintaining public housing. Standards might also vary more in both the short and long run. For example, standards could rise in the near term if PHAs increased spending for current operations, but could fall in the long run if PHAs were later unable to finance needed capital improvements.

Thus, the proposals now before the Congress to modify the current mechanisms for supporting public housing must be judged in terms of the number of public housing units to be supported, the services to be provided, and the degree of federal oversight to be exercised. Conversely, decisions about these issues--whether explicit or implicit--would determine the funding required for public housing and the resulting federal costs.

To help the Congress assess the alternatives before it, Chapter IV describes the current financing mechanisms and discusses concerns that have been voiced about specific features of them. Chapter V discusses the general approaches to setting federal subsidies for public housing and specific proposals to modify current programs, along with their costs and some of their implications.

CHAPTER IV. THE CURRENT SYSTEM FOR SUBSIDIZING PUBLIC HOUSING

The federal government subsidizes public housing in three ways. It first pays the debt-service costs of constructing public housing, and then it pays the debt-service costs of subsequent modernization. In addition, it provides operating subsidies to cover the difference between tenants' rent payments and operating costs. In 1982, total federal subsidies for public housing were $2.9 billion, or $2,400 per unit.

In recent years, federal costs for operating subsidies and modernization have risen sharply. Between 1972 and 1982, operating subsidies rose from $21 per unit per month to $95, or from $245 million to $1.3 billion in total--up nearly fivefold in a decade. Similarly, $900 million worth of modernization improvements were authorized in 1982--which will require $1.8 billion in debt-service payments spread over 20 years--up from $200 million worth of improvements provided in 1972.

Federal subsidies for operations are currently provided through the Performance Funding System (PFS), and subsidies for modernization are provided through the Comprehensive Improvement Assistance Program (CIAP). Both programs were intended as major reforms in previous subsidy programs, but each has come under growing criticism in recent years. The current programs and the concerns raised about their operation are the subject of this chapter.

SUBSIDIES FOR ANNUAL OPERATIONS

When the Congress limited rents to a fixed share of tenants' incomes in 1969, it also agreed to make contributions to public housing authorities' operating budgets to help fund the resulting gap between operating expenses and rent collections. Initial subsidies were determined by calculating the difference between each authority's expected expenditures and anticipated revenues. Subsidies in subsequent years were calculated by reviewing PHAs' budgets, and adjusting each upward by an estimate of inflation. Annual reviews of each PHA's budget were time-consuming, however, and allowed much discretion on HUD's part in setting funding levels. Further, because PHAs could often count on the federal government to cover revenue shortfalls, the system did not encourage efficient operations and led to rapidly rising costs.

In an attempt to simplify the system for awarding subsidies and to promote efficiency, HUD instituted the Performance Funding System in 1975. The PFS serves two primary functions. First, it is the means of estimating operating subsidy needs for public housing each year and becomes the basis of a funding request to the Congress. Second, it is the vehicle used by HUD to allocate appropriated operating subsidies among PHAs.

Under the PFS, federal subsidies are generally appropriated to cover the difference between allowable operating costs and anticipated rental income. Subsidies are forward-funded; that is, they are provided at the start of a fiscal year to finance ongoing operations. HUD sets a formula-determined allowable expense level (AEL) for each PHA and separately estimates utility and audit costs, all based on past levels for that PHA. 1/ The PHA's income is also projected, and its subsidy is the difference between anticipated expenses--the sum of the AEL, utility costs, and audit costs--and income.

$$\text{Operating Subsidy} = \text{Non-utility Allowable Expense Level} + \text{Utility Costs} + \text{Audit Expenses} - \text{PHA Income}$$

To the extent that public housing managers can operate at lower levels than HUD has projected, the additional funding is available for increased service levels or other uses, but to the extent that total funding is lower than required, managers must increase efficiency, reduce service levels, or attempt to secure assistance from local governments or private sources.

A key characteristic of the Performance Funding System is that, although it is called a "cost-based" subsidy system, operating subsidies are based on past funding levels, not on the actual cost of providing some specified level of public housing services. The alternative to this procedure--defining a desired level of services to be provided, and estimating the annual costs of achieving that service level for PHAs of varying types and locations--was considered when the Performance Funding System was instituted, but was rejected as too difficult. Basing operating subsidies on past funding levels makes the system relatively easy to administer, particularly for the large number of PHAs that receive annual subsidies. On the other hand, it makes it more difficult to assess whether PHAs in similar circumstances receive similar levels of federal assistance.

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1. HUD requires PHAs to have a biennial audit of their finances.

Allowable Expense Levels

Allowable expense levels (AELs) were established in 1975 for each PHA and have been adjusted annually since then for the effects of inflation and changes--particularly due to age--in the housing stock. They include all expenses except those for utilities and audits--that is, they include personnel costs, routine maintenance, security, social service activities, and payments to local governments in lieu of property taxes.

Initial Allowable Expense Levels. Allowable expense levels were initially set for all PHAs on the basis of the expenses of a group of 56 PHAs judged to be well managed by HUD officials, PHA personnel, tenants, and housing researchers. The operating costs of these PHAs were accepted as reasonable, and were used to establish a range of allowable operating costs. 2/ Expense levels for other PHAs were set at then-current levels if they fell within the designated range, and were increased thereafter for inflation and for changes in the housing stock. PHAs with operating expenses above the allowable range had subsidy levels fixed at then-current levels until subsequent adjustments raised the range of allowable costs.

The intention in basing allowable costs for all PHAs on the standard of well-managed PHAs was to promote efficient operation of public housing, but the manner in which it was instituted has been criticized as underestimating the operating costs of large urban PHAs, particularly those in distressed areas. 3/ For one, some of the factors that affect public housing operating costs--such as the prevailing area wage levels, vandalism experienced at a PHA, and conditions in neighborhoods surrounding a PHA's projects--were not included among the factors considered in setting cost levels, thus not accurately representing the conditions experienced by large PHAs. Further, the manner in which the costs of the group of well-managed PHAs were generalized to all PHAs had the effect of raising AELs of

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2. The range was established by examining the relationship between current expense levels and several characteristics of PHAs. The characteristics examined were: average age of project buildings, average height of buildings in floors, average number of bedrooms per unit, the effect of regional costs on PHA operating expenses, and the number of people in the area served by the PHA.

3. For a detailed examination of technical issues surrounding the Performance Funding System, see: Sally R. Merrill and others, Evaluation of the Performance Funding System: Technical Components, Decision Rules, and Administration, prepared by Abt Associates, Inc., for the Department of Housing and Urban Development (1980).

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relatively small PHAs and lowering those of large PHAs from the levels at which they would otherwise have been. As a result, large urban PHAs were much more frequently above the allowable range than other PHAs, and were unable to appeal the results.

Adjustment for Inflation. AELs have been updated each year since 1975 for the impact of inflation on operating costs. Until 1982, the measure of inflation used to update AELs was an index of local government wage rates. But because wages represent only about 60 percent of nonutility operating costs, the measure was changed in 1982 to a composite of local government wage rates and state and local government purchases, weighted 60 percent and 40 percent respectively, to reflect the major components of PHAs' budgets. 4/ The wage rate component is available for 426 local areas, while the purchases measure is available only on a national basis.

Because operating subsidies are funded in advance, AELs are updated by the anticipated level of inflation, not the actual level. During the recent years of high rates of inflation, the increases in PHA operating costs were consistently underestimated, resulting in a real decline in operating funds available to PHAs. When the new index was introduced in 1982, all AELs were adjusted to offset the underestimates between 1977 and 1981, but PHAs did not receive additional subsidies for earlier years and no provision has been made for such adjustments on a regular basis in the future.

Adjustment for Changes in the Public Housing Stock. 5/ The adjustment for changes in the public housing stock is calculated separately for each PHA and is based on: average building age, average building height, average unit size (in numbers of bedrooms), and metropolitan area population. 6/ The formula generally increases allowable expense levels by less than 1 percent a year, and has often been criticized as too complex relative to its small effect on operating subsidies.

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4. The state and local purchases index includes government spending for durable and nondurable goods, structures, and nonemployee services. A fifth component of the state and local government purchases index, employee compensation, is omitted to avoid double counting of the effects of wage rate changes.

5. This adjustment is often referred to as the "Delta" adjustment.

6. Although at one time Fair Market Rents for the area served by a PHA were also included, they were subsequently omitted.

Utility and Audit Costs

Utility costs are a major and growing share of public housing operating expenses, representing 40 percent of the total in 1982; audit costs, by contrast, are very small, representing about 0.1 percent of total expenses that year. In general, utilities and audits are treated under the Performance Funding System as expenses beyond the control of PHAs.

Allowable utility costs are based on projected consumption and rate levels. The consumption base is the average level over the three previous years, and the rate is either the one currently in effect or--if known--the rate for the coming year. At the end of each year, projected utility expenses are compared to actual levels. All increases in costs resulting from rate increases not included at the start of the year are paid by the federal government. Any savings or additional costs resulting from consumption below or above the base-period level are shared equally by the PHA and the federal government, providing the PHA an incentive to conserve energy.

HUD requires that PHA accounts be audited once every two years, and even PHAs that do not receive operating subsidies may have their audit expenses reimbursed by HUD.

PHA Income

The major source of a PHA's income--other than federal subsidies--is rent collections from tenants, with a smaller sum coming from interest earned on its investments. Rental income is projected by increasing the end-of-year average rent per unit to the expected level for the coming year. The average anticipated rent per unit is then multiplied by the number of units expected to be occupied.

In 1981, the Congress decided to increase tenants' rents from 25 to 30 percent of their adjusted incomes, and to limit the authority of PHAs to set rent ceilings and deductions from income. The effect of these provisions will be to increase rent collections and decrease the need for federal subsidies. 7/ For new tenants the increase was effective at the start of 1982, while for current tenants the increase is being phased in by increasing rents by 1 percent of income a year, with all tenants paying 30 percent by

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7. For further discussion of this point see: Department of Housing and Urban Development, Alternative Operating Subsidy Systems for the Public Housing Program (1982), Chap. 2.

1986. 8/ Even when fully implemented, rent collections will probably not go up by a full 20 percent, however. The rise in rents will probably make public housing less attractive than private-sector alternatives to a small number of higher-income tenants. Such tenants are likely to move out and be replaced by poorer tenants, who would pay lower rents for their units.

Several incentives are incorporated into the way the rent projections are made, which vary in their effects on public housing managers. First, PHAs are not allowed to make deductions for tenant delinquencies, thus prompting them to keep tenants current in their rent payments. Second, although PHAs may request an adjustment if projected rental income is higher than actual, no adjustment is made if projected levels are lower than actual. When PHAs had more flexibility in setting rent levels this was intended to provide an incentive to PHAs to increase rents. Now that the flexibility has been removed, it merely allows PHAs whose tenants' incomes have increased faster than anticipated to keep the increase. Finally, although vacant units are excluded from the count of revenue-producing units, they are counted in the number of units available for subsidy. Thus, if operating subsidies are higher than operating costs of vacant units, it may be financially advantageous to PHAs to hold vacant units.

A smaller source of income for PHAs, about 7 percent of the level of rent collections, is interest income. Most interest is earned on PHAs' reserves, though funds allocated to PHAs for modernization--described later in this chapter--may be held for short periods and may also accumulate interest. PHAs must count this income in determining federal subsidies, which creates a disincentive for maintaining large reserves.

Total Operating Subsidies

The annual operating subsidy provided by the federal government is the difference between a PHA's estimated expenses and its income. In 1982, operating subsidies averaged $95 per unit per month and ranged from $140 for very large PHAs to $36 for small ones (see Table 4). Most of the variation came in PHA expense levels. Nonutility allowable expense levels ranged from $77 to $153--a 100 percent variation. Utility costs varied from $55 per unit per month to $96--or 75 percent. Revenues varied much less, ranging, on average, from $90 per unit to $110.

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8. The legislation also includes a provision that tenants' rents may not rise more than 10 percent a year because of the increase, so a few tenants may not yet be paying 30 percent of income by 1986.

TABLE 4. COMPONENTS OF OPERATING SUBSIDIES UNDER THE PERFORMANCE FUNDING SYSTEM, BY SIZE OF PUBLIC HOUSING AUTHORITY, 1982 (In dollars per unit per month)

		Size of Public Housing Authority (PHA) a/			
	All PHAs	Very Large	Large	Medium	Small
Average Expenses					
Allowable Expense Levels	117	153	106	94	77
Utility Expenses b/	79	96	77	68	55
Total	196	249	183	162	132
Average Income					
Rent Collections	94	104	83	95	90
Other Income c/	7	6	7	8	7
Total	101	110	90	103	97
Average Subsidy d	95	140	93	60	36
Total Subsidy e/ (In millions of dollars)	1,184	784	180	110	111

SOURCE: Congressional Budget Office.

a. Very large PHAs are those with 6,600 or more units. Large PHAs are those with 1,250 to 6,599 units. Medium PHAs are those with 500 to 1,249 units. Small PHAs are those with 100 to 499 units.

b. Includes costs of audits and miscellaneous expenses.

c. Includes primarily interest earned on reserves.

d. Expenses less income.

e. This estimate excludes operating costs calculated outside the Performance Funding System, such as subsidies for Puerto Rico and the territories, and consequently is lower than the level reported in the President's budget for 1984.

By region, operating subsidies in 1982 were more than twice as large in the Northeast as in the West--$132 per unit per month compared to $60 (see Table 5). The largest part of this variation came in utility expenses, which were over twice as high in the Northeast as in the West--reflecting differences both in climate and in the average age of the public housing stock. As a result of the variation in subsidies, northeastern PHAs, with 40 percent of the units, received 60 percent of the subsidies, while western PHAs, with 8 percent of the stock, received 5 percent of the subsidies.

SUBSIDIES FOR MODERNIZATION

The second component of ongoing federal subsidies for public housing is the Comprehensive Improvement Assistance Program (CIAP), which provides funding to modernize public housing projects. Federal subsidies for major improvements date to 1968, when it became apparent that annual funding levels were insufficient to fund capital improvements to the public housing stock. The current modernization program was established in 1980 to address perceived shortcomings in previous modernization efforts.

Until 1981, the federal government provided about $290 million annually in capital improvements to public housing. HUD field offices allocated funds on a discretionary basis that reflected HUD priorities. The most frequent use of early modernization funding was building improvement, including such activities as repair or replacement of heating systems, exterior walls, kitchens, and bathrooms.

These modernization efforts were criticized both because ongoing maintenance decisions were divorced from modernization decisions and because of the lack of flexibility in setting goals. Separating maintenance from modernization meant that PHAs had an incentive to defer maintenance activities until modernization funds could be obtained, thus discouraging cost-effective choices between maintenance and major improvements. This was particularly true when adjustments for inflation were lagging behind actual cost increases so that PHAs were faced with real reductions in operating subsidies. Further, because HUD determined the priorities for allocating funds, PHAs could not be certain that funds would be available for various activities when needed. 9/

The goal of CIAP is to give PHAs authority for planning modernization activities and to avoid funding activities on a piecemeal basis. To that end,

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9. For further discussion of these points, see: Alternative Operating Subsidy Systems for the Public Housing Program, Chap. 7.

TABLE 5. COMPONENTS OF OPERATING SUBSIDIES UNDER THE PERFORMANCE FUNDING SYSTEM, BY REGION, 1982
(In dollars per unit per month)

	All PHAs	Region a/ Northeast	South	Central	West
Average Expenses					
Allowable Expense Levels	117	145	87	102	121
Utility Expenses b/	79	110	59	60	48
Total	196	255	146	162	169
Average Income					
Rent Collections	94	117	71	78	102
Other Income c/	7	7	7	7	8
Total	101	124	78	85	110
Average Subsidy d/	95	132	68	77	60
Total Subsidy e/ (In millions of dollars)	1,184	693	160	277	55

SOURCE: Congressional Budget Office.

a. See Appendix A for a list of the states included in each HUD region.

b. Includes costs of audits and miscellaneous expenses.

c. Includes primarily interest earned on reserves.

d. Expenses less income.

e. This estimate excludes operating costs calculated outside the Performance Funding System, such as subsidies for Puerto Rico and the territories, and consequently is lower than the level reported in the President's budget for 1984.

CIAP finances complete modernization for selected projects, with the intent of funding subsequent capital replacements for these projects out of a capital reserve fund.

CIAP has funded an average of nearly $1 billion annually in improvements since 1981. 10/ Funds are allocated among HUD regional offices based on the distribution of needs identified in the Perkins and Will study described in Chapter II, with HUD regional offices encouraged, though not required, to use these estimates in allocating funds within the region. PHAs submit proposals for the modernization of selected projects, and HUD field offices select projects on the basis of urgency, management feasibility, long-term cost savings, and degree of tenant and local government support. Little is known to date about the precise nature of the activities undertaken with CIAP funds, or the costs per unit to achieve comprehensive modernization, though HUD officials have begun to tabulate such data. When available, this information could be used to gauge progress toward meeting the rehabilitation needs of public housing, described in Chapter II.

Although CIAP addresses some of the problems associated with earlier modernization efforts, several issues remain. First, with limited funds available, comprehensive modernization means that some projects receive extensive improvements while basic repair needs in other projects go unmet. Second, because these funds continue to be allocated independently from operating funds, PHAs still lack incentive to consider the long-term consequences of ongoing maintenance decisions. Finally, although the original intention of the comprehensive modernization program was to establish a capital reserve fund for each project when its modernization was complete, this component has never been funded.

PROJECTED SUBSIDY LEVELS

Operating subsidies for public housing are projected to total $7.4 billion between 1984 and 1988, based on the Performance Funding System as currently structured, and $7.4 billion of capital improvements could be made if the 1983 level of services continued through 1988. Since improvements are financed through 20-year bonds, however, as much as $15 billion in budget authority would be needed for modernization over this period, making the total budget authority requirements for public housing subsidies nearly $23 billion over the five-year period.

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10. The total costs for 1981 to 1983, including debt service, will be $6.1 billion, spent over the 20-year term of the bonds issued to finance the work.

Operating subsidies under the Performance Funding System are expected to average \$106 per unit per month in 1984 and to rise by 13 percent to \$120 per unit by 1988 (see Table 6 and Appendix Table B-1). Total operating subsidies are expected to be \$1.4 billion in 1984 and to increase by less than \$200 million by 1988. 11/ The slow growth projected in operating subsidies is due in large part to the anticipated effects of increases in rents charged to public housing tenants from 1984 to 1988. Nonutility allowable expense levels under the Performance Funding System are projected to increase by 23 percent during the period, and utility costs to grow by 19 percent, while rent collections are projected to grow by 28 percent. 12/

Subsidies for modernization are set on a discretionary basis--rather than a formula basis--by the Congress each year, making it difficult to project future levels. In 1983, \$1.3 billion in improvements was funded, at a total cost of \$2.6 billion over the 20-year period that these expenses will be financed. Extending the same real level of capital improvements financed in 1983 through 1988 would require \$15 billion in budget authority to finance \$7.4 billion in capital improvements.

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11. It should be noted that these projections are based on past trends and do not consider the effects that current modernization efforts could have on costs. In particular, expenses for utilities could be lower in the future than in the past because of energy-saving improvements.

12. These estimates of the effects of the increase in rents are based on projections made by HUD. Other estimates are based on assumptions consistent with the Congressional Budget Office February 1983 economic forecast. For further detail, see: Congressional Budget Office, The Outlook for Economic Recovery (February 1983).

TABLE 6. PROJECTED FUNDING LEVELS UNDER THE PERFORMANCE FUNDING SYSTEM (PFS) AND THE COMPREHENSIVE IMPROVEMENT ASSISTANCE PROGRAM (CIAP), 1984-1988

	1984	1985	1986	1987	1988	1984-1988
	Average Funding Level (dollars per unit per month)					
Operating Subsidies Through the PFS a/	106	111	114	117	120	568
Modernization Subsidies Through the CIAP b/	213	220	230	241	252	1,156
Total	319	331	344	358	372	1,724
	Total Funding (millions of dollars)					
Operating Subsidies Through the PFS a/	1,370	1,470	1,500	1,530	1,550	7,420
Modernization Subsidies Through the CIAP b/	2,740	2,900	3,020	3,140	3,260	15,060
Total	4,110	4,370	4,520	4,670	4,810	22,480

SOURCE: Congressional Budget Office. More detailed projections and estimates of funding by size of public housing authority and region are included in Appendix B.

a. Includes only subsidies to PHAs calculated under the PFS and excludes subsidies calculated outside the PFS, such as those for Puerto Rico and the U.S. territories.

b. This is the budget authority required to fund the same real level of services each year as is being financed in 1983. The level of improvements that would be made would be roughly half of the budget authority amount.

CHAPTER V. OPTIONS FOR SUBSIDIZING PUBLIC HOUSING

The current mechanisms for subsidizing public housing were intended as major reforms, but over time they have come under increasing criticism. Concern about the Performance Funding System has focused on the manner in which funding levels are established and on the incentives it provides for efficient management. 1/ Questions about the Comprehensive Improvement Assistance Program have centered on the incentive it gives to postpone routine maintenance of public housing, where possible, until such time as modernization funds are available, and the inefficiencies that may result.

These concerns have led to a wide-ranging set of proposals for modifying current subsidies, and the Congress is considering two bills--H.R. 1 and S. 1338--that would change present practices (see Appendix C for a summary of the two bills). In general, the options are either to modify existing programs in relatively modest ways or to substitute an alternative approach to subsidizing public housing. Many observers would argue that the current levels of services provided through public housing are generally appropriate and that, while there may be difficulties with existing programs, it is preferable to adjust them rather than to substitute entirely new ones. Others--particularly within the Administration--argue that the current system lacks a mechanism for comparing public housing costs to other federal housing program costs, and that to spend more for public housing than is spent on providing assistance through the other programs is inefficient.

This chapter first outlines the general approaches to setting subsidies, and then considers options for subsidizing the public housing program.

SETTING SUBSIDY LEVELS FOR PUBLIC HOUSING

The current subsidy mechanisms could be modified in numerous ways to address recent concerns, as the range of options in the following sections indicates. In considering these options, at least two fundamental questions must be resolved:

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1. For a further discussion of the perceived strengths and weaknesses of the PFS see: Department of Housing and Urban Development, Alternative Operating Subsidy Systems for the Public Housing Program (1982), pp. 17-23.

- o Whether to provide subsidies for operations and improvements jointly or independently; and

- o What standards to use in setting funding levels.

The major proposals to modify public housing subsidies would address these questions in different ways. The House and Senate Banking Committees would continue to base operating subsidies on past costs through the Performance Funding System, though with some modifications. The Senate committee would additionally use PFS-defined operating costs as the basis for determining funding for capital improvements, thus providing operating and modernizing funds jointly. The Administration proposed this year, in its 1984 budget submission, a more comprehensive alternative whereby funding for operations and improvements would be provided jointly, but total funding would be based on the cost of providing comparable assistance through privately owned housing.

Separate Versus Joint Subsidies

One major consideration in designing subsidy systems for public housing is whether subsidies should be specifically designated for operations and for improvements. Their current separation reflects at least in part the evolution of federal involvement in public housing. When tenant incomes were no longer sufficient to cover operating costs, the federal government began contributing to ongoing costs. Later, when the stock became too deteriorated to maintain through current operating funds, the federal government established subsidies for modernization, including major capital improvements.

Whether subsidies should continue to be made separately for operations and improvements depends largely on the purpose they are to serve and on the relative ability of public housing managers to allocate funds. If the modernization of public housing units is regarded as essentially a one-time operation--when units are updated to current standards by replacing kitchen and bath features, augmenting wiring, improving energy efficiency, and so forth--then it may be logical for these funds to be viewed independently from operations, since the activities are not part of ongoing maintenance but, rather, one-time investments that will not be repeated in the near term. On the other hand, if modernization activities include types of activities that must be undertaken more regularly--replacement of broken fixtures and repair of roofs and heating systems, for example--then it may be reasonable to consider the outlays as operating expenditures, particularly since the level of current maintenance would affect future repair costs.

Current modernization subsidies skirt these questions. They are intended to provide comprehensive improvements, not to finance repair and maintenance needs. Because of limited operating budgets, however, CIAP funds are used for these activities as well. Further, while major repairs are meant to be financed from a capital reserve fund, moneys for this have never been explicitly appropriated, leaving open the question of how to meet future capital requirements.

Whether subsidies for improvements and operations should be provided jointly or independently will also depend on whether PHA managers can design effective investment strategies. If PHAs were given responsibility for the full range of operating and maintenance decisions, as private housing managers have, they would have an incentive to make cost-effective choices from among available alternatives. On the other hand, if they increased spending for current operations so that funding was unavailable for future repairs, then the quality of the public housing stock could erode or the Congress could feel required to provide supplemental subsidies.

Standards for Public Housing Subsidies

The standard for subsidy levels in public housing has always been controversial. A major rationale for using past levels has been that they are readily known and that PHAs have been able to operate at those levels. On the other hand, under such a system it is difficult to assess, first, whether overall funding levels are adequate and, second, whether individual PHAs are performing efficiently.

The major alternative to basing operating costs on past levels would be to peg them to the private-market operating costs used to set subsidy levels in other federal programs. The argument for this system is that, if public housing cannot be operated at levels comparable to private-market housing, then assistance would be more efficiently channeled through other means. The opposing argument is that private-market rent levels may not be reasonable measures of public housing expense levels.

OPTIONS FOR MODIFYING THE PERFORMANCE FUNDING SYSTEM

The two major sets of concerns raised about the PFS are the manner in which subsidies are calculated and the incentives offered for efficient management. These concerns could be addressed, at least in part, through incremental changes in the current system.

Setting Subsidy Levels Under the PFS

Subsidy levels under the PFS could be modified in at least four ways, by:

- Adjusting allowable expense levels;
- Reconciling differences between expected and observed levels of inflation;
- Reconciling differences between predicted and actual tenant rents; and
- Simplifying the annual adjustments for changes in the public housing stock.

Modifying Allowable Expense Levels. The goal of the PFS was to induce high-cost PHAs to operate more efficiently so as to lower their expenses to the levels of well-run PHAs, but the procedure used may have incorrectly identified some PHAs--particularly large urban ones--as inefficient and may have underestimated their operating expenses. The Congress could offset these underestimates either by increasing the nonutility allowable expense levels of large urban PHAs or by establishing an appeals process so that PHAs that believe that their subsidies are inappropriately low may request that HUD review and possibly increase their AELs. H.R. 1 would incorporate both an adjustment to the AELs of authorities operating in distressed areas and an appeals process into the Performance Funding System.

Because much of the data that would be needed to recompute initial allowable expense levels for each PHA no longer exist, adjustments would require using a proxy to identify those PHAs that had their actual operating costs underestimated. One option would be to increase allowable expense levels for PHAs located in communities receiving above-average per capita allocations under the Community Development Block Grant (CDBG) program. 2/ The CDBG program provides grants on an entitlement basis to large cities and urban counties, with localities in distressed areas receiving larger per capita grants than other, less distressed places. Thus, the recipients of above-average community development grants are, by and large, the types of communities in which initial AELs for public housing were underestimated. Under this option, PHAs in these communities would

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2. See: Alternative Operating Subsidy Systems for the Public Housing Program, Chap. 4.

receive subsidy increases of about 5 percent on average, with the exact amount depending on the extent to which the community development grant for that community exceeded the average grant. Very large PHAs, and PHAs located in the Northeast and Central regions, would receive adjustments more frequently than would other types, reflecting the distribution of CDBG funds.

If such an adjustment was made in 1984, subsidies would increase by about $40 million. Since CDBG allocations would only serve as a proxy for underfunded PHAs, the result might be to overcompensate some PHAs and undercompensate others--as would also be true if other proxies were used to adjust funding levels.

Another way to increase subsidies for PHAs that may be currently underfunded would be to establish an appeals process whereby HUD officials could review, on a case-by-case basis, the circumstances of individual PHAs. While such a process could avoid the difficulties of using a proxy and could allow adjustments to offset more recent changes in PHAs' operating circumstances not reflected in the PFS, it could increase HUD's administrative expenses and could be an also imprecise means of adjusting subsidy levels if HUD officials were inconsistent in their response to appeals.

The features of an appeals process could vary in many ways. It could be limited to only those PHAs that believed that their initial funding was too low or could be open to any PHA that felt that its current funding was inappropriate. Appeals could be allowed only for a limited period, or could be incorporated as an ongoing component of the subsidy system. Finally, the amount by which subsidies were allowed to increase could either be left to the judgment of HUD officials or could be established by formula. For example, an allowable range for public housing operating costs could be established on basis of recent research about the factors that affect costs, and PHAs could be allowed to appeal up to amounts within this range. 3/ The costs of such a system and its effects would depend on how these questions were resolved.

Reconciling Differences Between Expected and Actual Inflation. A second difficulty is that allowable expense levels are updated each year by the anticipated level of inflation, not the actual level. Unlike estimated

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3. Sally R. Merrill and Stephen D. Kennedy, Improving the Allocation of Operating Subsidies in the Public Housing Program: A Revised PHA Cost Equation and Range Test, prepared by Abt Associates, Inc., for the Department of Housing and Urban Development (1982).